Making S.M.A.R.T. Financial Decisions

Save More

Professor Terrance Odean

Saving is hard. I'm going to talk about six strategies for saving more. Not all of these strategies may work for you, but maybe one or two will.

Number one on the list is to automate savings. Have the amount you want to save each month, deducted from your paycheck, and deposit it directly in your retirement savings account. Or have it automatically transferred to your retirement savings when your paycheck is deposited in your bank account. I realize that automating savings does not reduce your expenses, but it does make it much more likely that you will save.

Number two, focus on the big stuff. First, insurance and mortgage. If you can get the same insurance or mortgage for less money, you'll be able to save more money with less pain. You've probably seen the Geico ads claiming that 15 minutes will save you 15%. You know, it's probably going to take you longer than 15 minutes. However, if you have auto, homeowner's, or other major insurance policies and haven't recently shopped for better prices, you're almost certainly going to save substantial money by doing so.

In the videos on insurance we'll talk more about comparison shopping for insurance policies, as well as lowering insurance costs by choosing higher deductibles. If you own your home and haven't recently refinanced, you may be able to save money by refinancing. Whether refinancing is going to save you money depends upon changes in interest rates since you got your mortgage. Currently, rates are low. So you may be in a position to save money. But you need to shop carefully for a new mortgage. You need to understand the costs and the fees that banks add to mortgages, and you have to get multiple quotes. Please watch the course video on refinancing before you refinance.

Now, your car. Is your car too expensive for your income? If so, sell it and buy a cheaper one. Is it getting old and scratched up? If you want to save money, keep on driving it. Sure, old cars need repairs occasionally, sometimes big ones. But on average, it's cheaper to maintain an older car than to buy a new one. Eventually though, you may have to let go. I parted company with my 1988 Volvo last year after driving it 225,000 miles.

If you own or rent a home which you can't afford, you're not going to be able to save today. Which means you'll live less well in your retirement years. So try to find a place you can afford. Moving is expensive, and it's emotionally difficult. But, in some cases, it is the right option. Or maybe you can find a roommate who can help you afford the place that you're in.

Number three, want to buy the same things for less? Save first, and then buy. Don't buy on credit. And don't rent to own. Want to spend 5%, 10%, 20%, or more on the things you buy? Get out your credit card and run up a big balance.

Number four, increase your income. Obviously, that's not always an option, but it might be for you. With your current skills, and experience, could you get a higher paying job? Could you earn more with another degree or professional training? In the long run, this could be a good way to increase your income. However, just as it's important to shop carefully for a mortgage, or for insurance, it's important to shop carefully for degrees, programs, and training programs. You want to make absolutely sure that you've got the necessary skills, and enough time, to successfully complete any program you start. And you need to be sure that the majority of students who've gone through the program you're considering ended up with good paying jobs in the field of the training. Finally, you need to compare the cost of education programs to the potential financial benefits.

Number five, comparison shop. This is crucial for big ticket items such as cars, computers, and refrigerators. But you can also save money on regular repeated purchases by finding a store that sells the item for less. Buy in bulk if you can, as long as bulk supply doesn't lead to bulk consumption.

Number six, don't neglect the small stuff. In his book, Smart Women Finish Rich, David Bach wrote that a young woman who gave up her daily $5 stop at Starbucks would likely have an additional $2 million by the time she was 65. That was a bit optimistic. By my calculations, if you save $5 a day for 40 years, you'd need to earn more than 12% annual interest compounded daily to end up with $2 million. But if you've got a more reasonable average annual market return of 7%, you'd still end up with around $380,000 at the end of 40 years. Of course, because of inflation, $380,000 won't buy you as much in 40 years as it does today. It will more likely buy you about what $140,000 gets you today. The importance of denying yourself small luxuries when trying to save has often been exaggerated. However, there is truth to the claim that small, regular savings do add up. The important insight is that spending is about trade-offs. If you are keeping your must have expenses under control, and saving 20% of your after tax income, you should spend your wants money, and fun money, how ever it makes you happiest. But you can only spend it once. $5 a day is about $152 a month, or $1,825 a year. Would you rather enjoy a daily cafe latte venti, a monthly dinner at your favorite fancy restaurant, or a more expensive annual vacation? Would you like to give some of that money to others? It's up to you. The money you budget for things you want is yours to spend as you want. But you can only spend it once.